THE COMPASS
MINNEAPOLIS/ST. PAUL

OFFICE

JANUARY 2013

Twin Cities Office Market Gets Solid Marks in 2012 with 1 Million Square Feet of Positive Absorption, Teed Up for Class A Landlords in 2013

PUSH FOR LOWER VACANCY

With 1 million square feet (msf) of positive absorption for the year, the Twin Cities office market is in its best shape since 2007. Overall vacancy at year end was 18% for direct space across all property types, down 1.2 percentage points from 19.2% a year ago. Most encouraging for landlords were signs of better pricing power for rental rates. In the West submarket, rental rates for class A space rose by 10% during the year to an average of $29.69 gross psf, $16.87 net psf. In the Minneapolis Central Business District (CBD), low vacancy in class A buildings has yet to translate into true pricing power for landlords, but the conditions for rental rate hikes are being established. The average rental rate across all property types and submarkets was $23.81 gross psf, $12.81 net psf, at year end—a slight downward tug from the third quarter.

SHADOW OF SUBLEASE SPACE ALMOST GONE

Sublease space is no longer the major factor in the market that it has been in recent years. Not since 1997 has the market seen so little sublease space as is now available. That said, there are some concerns about additional space entering the market due to corporate downsizing and consolidation among some of the larger space users. Downsizing is still a significant factor, especially in the Minneapolis CBD where some larger users, including several law firms, are considering utilizing more efficient office configurations as their current leases expire over the next few years.

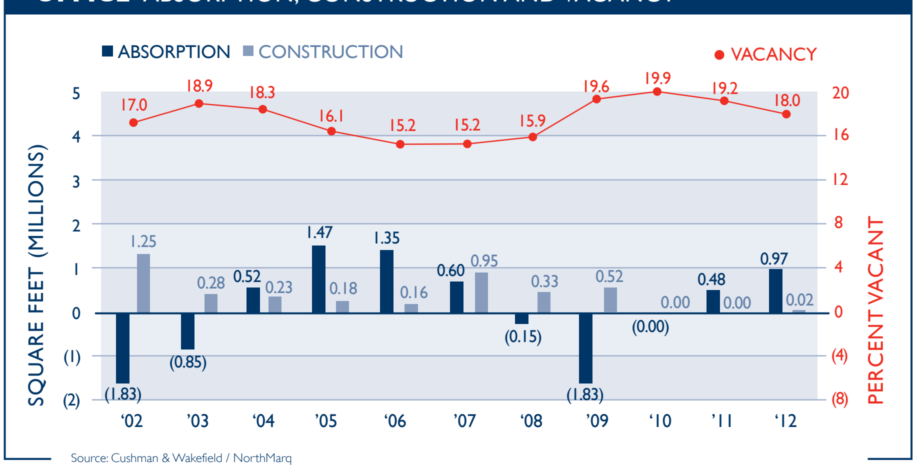
I-394 CORRIDOR CONTINUES TO EMERGE AS POWER STRIP FOR OFFICE

The path to recovery in the Twin Cities office market is being paved this time around by the West submarket, which has emerged as the low-vacancy leader in office space—especially along the I-394 corridor stretching from Highway 100 on the east to I-494 on the west.

Dubbed by some as the "Golden West," the I-394 corridor boasts a vacancy rate among class A properties of just 7.8%, partly due to no speculative development being delivered since 2003. Larger space users are expected to begin shifting their attention further to the north and west areas of the submarket in 2013 as their options for space in the 11 class A buildings along the corridor have largely evaporated.

The Southwest and Northwest submarkets could see more users coming their way as conditions tighten in the West.

OFFICE ABSORPTION, CONSTRUCTION AND VACANCY



Source: Cushman & Wakefield / NorthMarq

OFFICE VACANCY AND ABSORPTION

SUBMARKET	TOTAL # OF BUILDINGS	NRA	VACANT SPACE	PERCENT VACANT	PERCENT VACANT W/ SUBLEASE	1ST HALF 2012 ABSORPTION	2ND HALF 2012 ABSORPTION	2012 ABSORPTION
Minneapolis CBD	106	26,229,034	4,234,910	16.1%	18.4%	248,251	147,835	396,086
Northeast	118	7,578,255	1,421,736	18.8%	19.3%	(38,967)	160,890	121,923
Northwest	36	2,364,711	865,235	36.6%	37.1%	(60,412)	(45,096)	(105,508)
South/Airport	81	5,770,573	993,563	17.2%	17.4%	146,137	68,567	214,704
Southwest	142	14,315,902	2,451,632	17.1%	17.8%	112,195	127,878	240,073
St. Paul CBD	44	6,890,172	1,628,932	23.6%	24.2%	10,207	43,669	53,876
West	97	8,796,560	1,327,492	15.1%	15.5%	68,968	(23,234)	45,734
TOTAL MARKET	624	71,945,207	12,923,500	18.0%	19.1%	486,379	480,509	966,888

Source: Cushman & Wakefield / NorthMarq

COMPONENTS IN PLACE FOR RENTAL RATE INCREASES IN MINNEAPOLIS CBD, BUT NOT A CLEAR PATH

Class A landlords are facing a unique situation. Several components are in place to increase rental rates: no new development, vacancy rates in Class A properties are below 10%, and the number of options for larger users are being reduced. But tenants are also considering competitive class B properties in the Minneapolis CBD.

Vacancy among class B properties is still above 24%, even as direct space vacancy in class A buildings has plunged to 9.7%. Some of the better-positioned class B buildings are attracting interest from space users willing to put aside their class A aspirations for a more modestly priced class B property. This has put a damper on the ability of owners of class A properties in the CBD to put upward pressure on rental rates. Many of these owners anticipated a stronger market for rental rates once the class A vacancy rate dropped below 10%. But the better B buildings are creating enough of a financial gap in pricing that tenants are considering those options.

OUTLOOK

Assuming the country sidesteps the fiscal cliff and avoids another recession, the Twin Cities office market seems poised for accelerated growth in 2013. Certainly there are concerns, such as the potential fallout from corporate restructurings at companies such as Best Buy Corporation and SuperValu, but the overall trend is positive across most submarkets. The market appears set to achieve 1.3 msf of positive absorption in 2013. The West submarket is expected to set the pace again in the year ahead and may see 13% vacancy by year end.

No new office construction completions are scheduled for 2013, and no new speculative office product of any type is currently underway. Developers have numerous projects in preliminary planning mode, but none have been given the green light.

On the corporate side, Wells Fargo Corporation is discussing a possible new office tower or relocation to an existing property. One area for new development being considered is in the Downtown East area of Minneapolis, near the soon-to-be built Minnesota Vikings stadium, that could accommodate the need to consolidate and expand its operations in the region.

MORE ONLINE

- Landlords gaining pricing power
- Demand for user-building sales outpaces supply
- An in-depth look at each submarket's numbers, trends and transaction activity

CUSHMAN & WAKEFIELD® | NORTHMARQ

3500 American Blvd W, Suite 200
Minneapolis, MN 55431
952.831.1000
info@cushwakenm.com
www.cushwakenm.com

The Compass report includes information for multi-tenant office, industrial and retail projects greater than 20,000 sq. ft. and multi-family for-rent properties. Not included are owner-occupied, government or single-tenant buildings. Not all information and insights we've collected can be published in any given volume.